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## SETTING THE STANDARD

LEADERSHIP EXPERTISE TRANSPARENCY TEAMWORK ENFORCEMENT COOPERATION REGULATION COMMITMENT ACCESSIBILITY

ONTARIO SECURITIES COMMISSION

OSC

2005 Annual Report

## Highlights

### Mutual Fund Probe

The OSC completed an intensive, year-long probe into late trading and market-timing practices in the mutual fund industry. As a result of settlement agreements reached with five fund managers, \$205.6 million is being paid to investors who were harmed by frequent trading market timing activity.

 see page 12

### Guidelines for Corporate Governance

The OSC and other securities regulators published guidelines for effective corporate governance practices. The guidelines were developed to recognize that governance practices are evolving and to achieve a balance between providing protection to investors and fostering fair and efficient capital markets. Public companies are asked to consider the guidelines in developing their own governance practices.

 see page 16

### Fee Rebate for Market Participants

The Commission approved a one-time rebate of \$15 million in fees to market participants in Ontario. The rebate represented a portion of the regulatory fees market participants had paid over the previous two years, and reflected the stronger than expected revenues under the OSC fee model.

 see pages 8 and 27

### Investor Town Hall

More than 400 people attended the first OSC Town Hall to discuss the experiences of retail investors. The Town Hall was an opportunity for retail investors to talk about their concerns and questions with regulators from the securities, brokerage and mutual fund industries.

 see pages 24 and 25

### International Conference on Intelligence Led Regulation

The OSC hosted representatives from 18 countries for an international conference about combating organized crime in the financial markets.

### Supporting Regulatory Reform

The OSC encouraged and supported the Government of Ontario's initiative to advance the establishment of a common securities regulator for all provinces and territories, with one set of securities laws and a single fee structure for regulatory services.

### Guidance on Income Trusts

Securities regulators, including the OSC, published additional guidance for investors which enhances the information available about income trusts.

### Investment Fund Governance

In conjunction with the Canadian Securities Administrators (CSA), the OSC published a second comment a revised version of a proposed rule on the governance of investment funds which focuses on enhancing investor protection.

### National Registration System

Working with the CSA, the OSC helped develop and launch the National Registration System, which harmonizes, streamlines and modernizes the registration process for individuals and firms across all jurisdictions.

### Improved Disclosure

The OSC implemented and began enforcing new and improved rules for continuous disclosure, certification of disclosure, and auditor oversight for public companies.

### Cooperation and Consultation

OSC staff worked on numerous projects with regulators across Canada and in other countries. Also, the increasing level of partnership on regulatory activities between the various Branches and Offices of the OSC has been particularly positive.

### Standing Committee on Finance and Economic Affairs

The OSC testified before the provincial legislative committee that reviewed the Report of the Five Year Review Committee on the *Securities Act*, commissioned by the provincial government. The government and the OSC are responding to the findings of the committee.

### Accessibility

The OSC received more than 38,000 contacts from the public, via different communications channels, over the period from April 1, 2004, to March 31, 2005. The organization also published its Customer Service Commitment Statement.

### Business Recovery Planning

OSC staff completed the implementation and testing of the OSC's Business Continuity Plan offsite facility.

The OSC's objective is to ensure capital markets operate by a set of standards that will build confidence and attract both issuers and investors.

Setting standards and living up to them comes from within.

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### Breakdown of Revenue and Expenses

Figure 1 – OSC Fees by Type

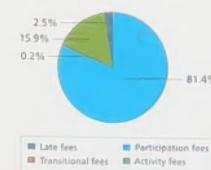
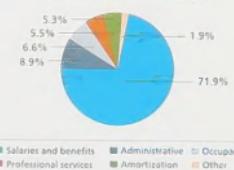


Figure 2 – OSC Expenses by Type



The OSC's objective is to ensure capital markets operate by a set of standards that will build confidence and attract both issuers and investors.

Setting standards and living up to them comes from within.

## Leadership



**Left to right:** Paul Moore, Vice-Chair; David Brown, Chair; Susan Wolburgh Jenah, Vice-Chair; Charles Macfarlane, Executive Director

Looking back on my tenure, the last seven years were a time of unremitting change. Constant change has become the new normal in capital markets, requiring regulators to be nimble and flexible. The Ontario Securities Commission adapted superbly in this environment.

**We have surrounded ourselves with dedicated and able staff. They understand the markets and the issues facing the markets and bring all this to bear in pursuit of our mandate.**

David Brown

Many of our recent priorities were shaped by two transformational events: 9/11 and Enron. After 9/11, we worked with our international colleagues to improve how we share information. After Enron, we designed a Canadian response to restore investor confidence and increase corporate accountability. We now cooperate more closely than ever with counterparts in other jurisdictions and I encourage the OSC to continue providing leadership and innovation in tackling national and international regulatory challenges.

Moreover, we changed the way the OSC works. We built areas of specialized expertise that are available to the entire organization, and learned to harness the depth and breadth of the knowledge of our staff like never before. We now bring together multi-disciplinary teams to deal with complex issues – such as the OSC's probe into mutual fund trading practices – that are increasingly inter-related. And we set internal standards that are as rigorous as those we expect major corporations to achieve.

These changes to the way we work contributed to the considerable accomplishments of the OSC. We have increased our enforcement presence in the marketplace. We have been a leader in achieving greater harmonization and simplification of the securities regime in Canada. We are respected internationally for promoting and fostering regulatory cooperation. And we have a strong record in protecting investors on issues such as corporate governance, accounting and financial disclosure.

In this era of relentless change, the OSC has a great team in place to pursue the organization's strategic goals while handling unexpected challenges. The staff have the necessary focus and dedication to ensure the OSC meets its dual mandate of providing protection to investors and fostering markets with integrity. I extend best wishes to the new Chair, David Wilson, in leading the OSC forward.

I am very satisfied with how the OSC responded to the unprecedented challenges of recent years and delivered solutions to the capital markets in Canada. It is gratifying to see the results of the hard work of the team. To the Commissioners, Vice-Chairs Paul Moore and Susan Wolburgh Jenah, Executive Director Charlie Macfarlane and the entire staff, I want to thank you for contributing to one of the most rewarding experiences of my life.

Sincerely,

**David A. Brown, Q.C.**  
Chair, Ontario Securities Commission

## Continuity

The following initiatives have been key objectives for the OSC and incoming Chair David Wilson has said they will continue to be major priorities and that he wants to build on the OSC's momentum:

- **Strengthening the OSC's enforcement capabilities:** The Enforcement Branch grew from 38 employees in 1998 to more than 90 in 2005.
- **Regulatory reform:** The OSC is a leading supporter of regulatory harmonization and will continue to support the Ontario government's initiative to establish a common securities regulator for Canada.

- **International cooperation:** It's a priority for the OSC to be involved in international regulatory initiatives. The OSC's participation assists it in achieving a level of protection for investors which meets or exceeds international standards.

- **Preventing harm to retail investors:** The OSC is concentrating more resources on activities that prevent harm to retail investors, who represent an important part of the capital markets. It is important to strike the right balance between providing strong investor protection and fostering fair and efficient capital markets.

## Incoming Chair David Wilson



**The OSC is respected around the world and I'm excited about becoming involved with this organization.**

David Wilson

contribute to the objective of ensuring that Ontario has the most effective and internationally competitive regulatory system possible.

Following his retirement from Scotiabank on October 31, 2005, Mr. Wilson will succeed David Brown, who stepped down as OSC Chair on June 30. In the interim, Vice-Chair Susan Wolburgh Jenah is Acting Chair of the OSC.

## Message from the Acting Chair

It is an honour to serve as Acting Chair of the Commission. I have found it most rewarding to keep us moving forward on important initiatives and priorities. Transition periods can be a challenging time for organizations. I am proud of the way the Commission and staff have worked together to ensure that this period of time continued to be productive and to assure a smooth and seamless transition to our incoming Chair, David Wilson.

I wish to thank my fellow Commissioners, Vice-Chair Paul Moore, Executive Director Charlie Macfarlane and Commission staff for their tremendous support and encouragement. I congratulate David Wilson on his appointment as Chair and look forward to working with him as he guides the OSC into the future.

Sincerely,

**Susan Wolburgh Jenah**  
Acting Chair

W. David Wilson has been appointed as the new Chair of the Ontario Securities Commission, effective November 1, 2005. At the time of his nomination, Mr. Wilson was Vice-Chair of Scotiabank and Chair and Chief Executive Officer of Scotia Capital in Toronto, and was responsible for managing the firm's global wholesale banking activities.

Having worked in the securities industry for more than three decades, Mr. Wilson has extensive capital markets experience and a demonstrated ability to lead complex organizations. He has advised the Government of Ontario on its initiative to establish a common securities regulator in Canada and sat on the provincial government's Five Year Review Committee, which reviewed the *Securities Act*.

Mr. Wilson was a founding Director of the Mutual Fund Dealers Association of Canada from 1997-1998 and served as Chairman of the Investment Dealers Association of Canada in 1996-1997. He has demonstrated his commitment to

## Expertise

The Ontario Securities Commission is a Crown Corporation responsible to the Ontario Legislature through the Minister responsible for securities regulation. Members of the Commission are responsible for the administration of the *Securities Act* in Ontario and are charged with performing the duties assigned to them under this legislation.

The Commission's statutory mandate is to provide protection to investors from unfair, improper or fraudulent practices and to foster fair and efficient capital markets and confidence in their integrity. Commissioners also serve as the Board of Directors of the Crown Corporation and are responsible for overseeing the management of the financial affairs and governance practices of the OSC.

In its own management, the Commission is committed to following best practices of corporate governance as well as promoting good governance among market participants. The Commission seeks to demonstrate sound governance, including effective oversight, accountability and transparency.

The Commission serves three primary functions: it is the OSC's Board of Directors, policy-making body and independent adjudicative tribunal. It sets the OSC's overall priorities, oversees strategic planning and financial reporting policies, and serves as an administrative tribunal with adjudicative responsibilities. Thus, the Commission's mandated role features differences from that of a typical board of directors. Each Commissioner is appointed by an

Order in Council and a single term cannot exceed five years, although a Commissioner may be reappointed. The Commission, as a whole, provides an extensive range of legal, accounting and capital markets expertise.

As of March 31, 2005, the Commission was comprised of 10 independent Commissioners, as well as the OSC Chair and the two Vice-Chairs. None of the independent Commissioners is employed by the OSC.

## Accountability

The Commission's relationship with the Minister is governed by a five-year Memorandum of Understanding (MOU), setting out the accountability relationship between the Commission and the Minister. Currently, the Hon. Gerry Phillips, Minister of Government Services, is the Minister responsible for securities regulation and the Minister responsible for the OSC. The MOU describes the responsibilities of the Minister, the Chair, and the Commissioners, and specifies that the Commission is required to provide the Minister with an annual report and an annual business plan.

To ensure that its agenda is consistent with the interests of stakeholders, the Commission is required to deliver to the Minister by June 30 of each year a statement of its priorities for the current fiscal year. The Statement of Priorities explains



### Commissioners:

(Sitting from left) Carol Perry, Robert Shirriff (Lead Director), David Brown (Chair)  
(Standing from left) Suresh Thakrar, Lorne Morphy, Harold Hands, Wendell Wigle, David Knight,  
Paul Moore (Vice-Chair), Susan Wolburgh Jenah (Vice-Chair), Paul Bates; (Absent) Theresa McLeod and Robert Davis



the OSC's goals in connection with the administration of the Act as well as the major activities planned to achieve those goals.

The Commission invites public comment on the draft statement prior to submitting the final document to the Minister and then publishing it on the OSC website ([www.osc.gov.on.ca](http://www.osc.gov.on.ca)).

Apart from the government, the OSC has a variety of other stakeholders and consulting effectively with them is considered an essential part of the regulatory and governance process. To this end, the OSC has established several advisory committees to provide input on important initiatives. These committees assist the Commission and staff in improving their understanding of the concerns and issues faced by stakeholders.

Furthermore, promoting responsiveness and public participation is an underlying principle of the OSC's rule-making process. The *Securities Act* specifies the matters in respect of which the Commission may make rules and requires the Commission to publish proposed rules for public comment. The comment period is a vital mechanism for gathering feedback during the policy-making process. Before it comes into force, the final form of a rule must be delivered to the Minister for review and approval.

Another important area of Commission oversight is financial accountability. The Commission as a whole is responsible for overseeing the budget and financial policies of the OSC. The OSC is a self-funded agency that seeks to ensure that the fees paid by issuers and registrants fairly reflect the costs of regulating each group. To achieve the goal of becoming revenue-neutral, the fee schedule is adjusted every three years to offset accumulated deficits or surpluses.

## Oversight

In fiscal year 2005, the Commission met bi-weekly to consider policy, rule-making, financial and other matters. In addition, as a corporation, it held six regular Board meetings and six special Board meetings. Attendance at meetings was 95 per cent during this period. The Commission held two offsite retreats as part of the process of setting its strategic direction and business priorities.

The Commission has in place three standing committees – Audit and Finance, Compensation, and Corporate



### Our Thanks to David Brown

David Brown retired as Chair on June 30, 2005, after leading the OSC through a critical period for both the organization and global capital markets.

During his seven-year tenure, David guided the transformation of the OSC from a government agency to a self-funding Crown Corporation. He provided determined leadership in the wake of extraordinary international events – including 9/11 and the collapse of Enron – and in crafting the appropriate responses by Canadian regulators.

As Chair of the Board, David displayed great ability to involve a diverse group of qualified and experienced people in debate and discussion during Commission meetings, and to bring discussions to a satisfactory conclusion. He brought exceptional communications and team-building skills to his role as Chair.

The depth and breadth of the OSC's policy agenda since 1998 were significant and David provided inclusive and collegial leadership to the Commission and staff. He surrounded himself with a group of extremely bright and motivated professionals to tackle the many issues encountered at the OSC.

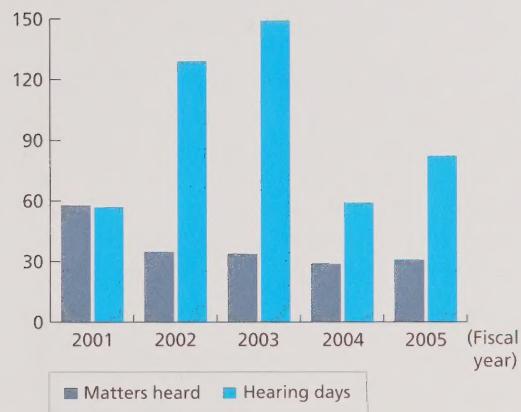
On adjudication matters, David showed great confidence in the Commissioners and staff who carried out the adjudicative functions of the Commission.

David Brown always led by example. His professionalism and respect for his colleagues are hallmarks of his tenure as Chair. He strengthened all aspects of the Commission and his successor will inherit a united and energetic OSC. The Commissioners extend our thanks and best wishes to David.

# Transparency

Governance and Nominating – which meet regularly. To ensure independent stewardship, all of the voting members and committee Chairs are independent Commissioners, with the exception that the Chair of the Commission is an *ex officio*, non-voting member of the Corporate Governance and Nominating Committee. In addition, an adjudicative committee is responsible for overseeing the Commission's adjudicative practices and procedures. In order to maintain an independent and dispassionate viewpoint on Commission issues, members rotate among the standing committees and their tenure is subject to term limits.

## Hearings before the Commission



In keeping with the OSC's governance guidelines for reporting issuers, the members of the Audit and Finance Committee are independent Commissioners with demonstrated financial literacy in order to provide effective oversight of the integrity of the OSC's accounting, financial and reporting policies and practices.

## Independence and Transparency

Independent Commissioners provide a public voice in the Commission's ongoing policy direction and execution. Their independence is pivotal to the commitment to fair and effective governance.

For example, since the *Securities Act* combines the roles of Commission Chair and OSC Chief Executive Officer, the Commission appointed a Lead Director, a role filled by an independent Commissioner. The Lead Director is responsible for overseeing the governance practices of the Commission, in consultation with the committee chairs and OSC Chair.

The Commission makes it a priority to ensure that members of the Commission have the skills, experience and the proficiency to achieve its mandated goals. The Commission maintains and regularly reviews its member profile which sets out the aggregate experience and expertise required. This practice encourages a wide breadth of expertise on the Commission.

Commissioners have experience in securities and corporate law, litigation, accounting and various aspects of the capital markets. Their insights and diverse viewpoints are invaluable in helping the Commission successfully discharge its mandate. Commissioners are also provided comprehensive education opportunities, including training courses for adjudicators.

The independent Commissioners hold their own regular meetings, chaired by the Lead Director, for discussions on a variety of matters.

On adjudication matters, the Commission exercises its oversight through setting enforcement priorities and approving budgets for the Enforcement Branch. Independent Commissioners and the Vice-Chairs sit on adjudicative panels convened to consider allegations by OSC staff of breaches of securities law and to preside over hearings involving matters of regulatory policy but, in order to preserve their impartiality, are not involved in specific enforcement activities. The Commission Chair participates in making specific enforcement operational decisions but does not sit on adjudicative tribunals.

## Committees of the Commission

The activities of the committees are another important component of the exercise of the Commission's oversight duties.

The responsibilities of the Corporate Governance and Nominating Committee include monitoring and periodically evaluating the Commission's governance policies, practices and procedures. This committee is also responsible for recommending candidates for appointment as Commissioners to the Commission, which delivers its recommendations to the Ontario Government. For the past two years, every one of the Order in Council appointments to the Commission has been reviewed by an all-party committee of the Legislature. During that time, the Committee recommended eight appointees, all of whom were appointed following a unanimous recommendation by the legislative committee.

The Audit and Finance Committee has a number of duties, including assisting the Commission in fulfilling its fiduciary responsibility for carrying out the oversight of the integrity of the accounting, financial and reporting practices of the Commission. Members also oversee both the OSC's external auditor and the internal audit functions.

For the past seven years, the Auditor General of Ontario has fulfilled the function of independent external auditor, reviewing and auditing the OSC's financial statements. To serve the function of an internal auditor, performing work requested by the Audit and Finance Committee, the Committee recommends the appointment of an independent firm. Ernst & Young currently fulfills this function.

The Compensation Committee, made up of independent Commissioners, is responsible for negotiating and recommending the remuneration of the Chair, Vice-Chairs and Executive Director and the compensation for part-time Commissioners. As part of its deliberations, it consults with a three-member committee, made up of the chair of the Commission's Compensation Committee and two members appointed by the Minister from outside the OSC.

Independent Commissioners also provide necessary oversight to the adjudication process. The Adjudicative Committee is comprised of the two Vice-Chairs and independent Commissioners, but excludes the Commission Chair. The Committee oversees the OSC's adjudicative procedures and practices and makes recommendations, when appropriate, to the Commission.

## Stewardship

The Commission believes it is important that stakeholders understand how it functions and the basis for its decisions. To that end, it is continually examining methods to make its decisions and processes more transparent, including ways to make greater use of the OSC's website and annual report.

The Commission's commitment to good governance acknowledges the crucial role it fulfills for all Ontarians in the oversight of the *Securities Act*. Consequently, the Commission remains committed to providing leadership and will continue to improve its governance practices, within the terms of its statutory mandate, to achieve the objective of meeting or exceeding what is expected of market participants.



For details on the professional background of each Commissioner and more information about OSC governance practices, see the 'Governance and Accountability' section of our website ([www.osc.gov.on.ca](http://www.osc.gov.on.ca))

## Committees of the Commission

Effective May 1, 2005



\*Secretary to the Commission

## Teamwork

One of the most important ways the Ontario Securities Commission has set the standard for providing effective and efficient regulation is by delivering on promises made to our constituents. We focus on the important priorities for the capital markets and strive to meet our commitments on schedule and on budget.



**We must spend money wisely, maintain excellent internal controls and promote high staff morale.**

Charles Macfarlane

Our core promise is to provide protection to investors from unfair, improper and fraudulent practices and to foster fair and efficient capital markets and confidence in their integrity. As such, the OSC is accountable to its constituents, just as 'the Street' is accountable to clients and regulators. We listen to our stakeholders' concerns and advice about significant issues, and respond in an efficient manner. ■

Like the business community, we must spend money wisely, maintain excellent internal controls and promote high staff morale. The OSC has pledged to exhibit financial accountability in its affairs in order to show the high value of each regulation dollar. The \$15-million rebate in fees issued by the OSC to market participants this year was one demonstration of our accountability. And our employee surveys have consistently revealed a healthy and growing degree of satisfaction among staff.

To ensure the most effective use of our resources, the OSC employs a variety of risk-based models designed to target those activities and market participants where problems are more likely to arise. We are focussed on mitigating the maximum amount of risk with the resources we have available to us. These risk-based approaches are used, for instance, to screen prospectuses, candidates for continuous-disclosure reviews, potential enforcement cases and potential

candidates for compliance reviews. Successful regulation often depends on how efficiently resources are allocated.

The OSC understands that cooperation yields results. Our relationships with other regulators, self-regulatory organizations, law enforcement agencies and governments help us promote confidence in Ontario's markets. For instance, the partnership between the OSC and the RCMP is seen as a model of cooperation between enforcement agencies and we are making significant contributions to major initiatives of the Canadian Securities Administrators and International Organization of Securities Commissions.

The year 2005 is a time of transition for us. After seven years as Chair, David Brown stepped down on June 30. David was a tremendous leader who guided the OSC through a period of significant change. We are all very grateful to David for his advice, leadership and commitment to excellence.

We now look forward to working with our new Chair, David Wilson, to meet the challenges of regulating a dynamic capital market. David is an impressive leader whose considerable management expertise and comprehensive knowledge of the securities industry will serve the OSC well.

The people at the OSC are the ones who deliver on our promises day in and day out. I want to thank our staff for their hard work and professionalism and congratulate them on their many accomplishments over the past year.

A handwritten signature in black ink.

Charles F. Macfarlane  
Executive Director



For more information on the OSC's Major Achievements, see page 9

# 2004/2005 Achievements

This table highlights some of the OSC's major initiatives during 2004 and 2005. For a full review of objectives for the coming year visit our website. [www.osc.gov.on.ca](http://www.osc.gov.on.ca)

## Prevention, detection and deterrence

- Completed the Mutual Fund Probe with settlement agreements with five fund managers, who agreed to distribute a total of \$205.6 million to harmed investors.
- From April 1, 2004, through March 31, 2005, the OSC initiated 52 enforcement proceedings, while 35 cases resulted in sanctioning orders or settlements.
- Commenced the new "simplified process" of investigations, a joint endeavour by the Enforcement and Corporate Finance Branches.
- Helped create a national Cease Trade Order database.

## Accountability, transparency and efficiency

- Issued a \$15-million rebate in fees to market participants, reflecting stronger than expected revenues. OSC's excess of revenue over expenses for 2005 was \$4.1 million, net of the rebate, compared to a projected surplus of \$6.2 million.
- More than 400 people attended the first OSC Investor Town Hall on May 31, 2005.
- Published the guidelines that OSC staff use to decide if it is appropriate to disclose an ongoing enforcement investigation.
- All OSC publications are available electronically on our website.
- IT staff successfully tested the offsite facility of the OSC's Business Continuity Plan.

## Good regulation

- Published corporate governance guidelines in June 2005 to give issuers guidance on governance practices.
- In conjunction with the CSA, published additional guidance that enhances the information available about income trusts.
- Cost-benefit analyses were completed and published for major projects such as MI 52-111: *Reporting on Internal Controls over Financial Reporting*.
- Placed substantial terms and conditions on the operations of five major Scholarship Plan Dealers.

## Harmonization and cooperation

- Playing the leadership role in the CSA's Registration Reform Project, as part of the CSA's effort to enhance the harmonization of Canada's regulatory regime. The first phase of the Project, the National Registration System, was implemented in April, 2005. The Project's website ([www.rrp-info.ca](http://www.rrp-info.ca)) was launched in June, 2005.
- Participated in publishing a nationally harmonized set of continuous disclosure requirements for investment funds which came into effect on June 1, 2005.
- Worked on IOSCO Task Force that developed a Code of Conduct for credit rating agencies.
- Hosted the International Conference on Intelligence Led Regulation – Organized Crime in the Global Financial Markets in September, 2004.
- Enhanced enforcement secondment programs with securities regulators in Britain and Australia.



Statement of Priorities for 2005/06 on  
[www.osc.gov.on.ca](http://www.osc.gov.on.ca)

# Enforcement

At a time of rapidly evolving capital markets, the OSC's approach to enforcement remains consistent and precise: It strives to be vigorous, fair and efficient in its administration and enforcement of securities laws in Ontario.

The OSC's primary concern is to target conduct that is harmful to capital markets, such as abusive trading. To that end, enforcement efforts concentrate on areas that will have the most significant impact on protecting those markets, to the benefit of Ontarians and other investors. Specifically, the OSC intends to increase its focus on activities that protect retail investors, already an area of considerable attention for the Enforcement team. Currently, the majority of OSC enforcement cases involve matters related to retail investors. And the OSC wants to do even more. By devoting more resources to enforcement, the OSC has broadened its efforts to prevent and detect fraud through surveillance and market intelligence.

To provide vigorous enforcement, the OSC has shown leadership in working to raise the level of awareness in the legal and law enforcement systems about market crimes. Also, the OSC is developing closer contacts with other regulators, self-regulatory organizations and law enforcement agencies to help coordinate all aspects of the enforcement process. Authorities have made progress in these areas:

- Insider trading is now a Criminal Code offence;
- The maximum sentence for fraud was increased from 10 to 14 years;
- The RCMP has committed more resources to investigating capital market crimes and has three Integrated Market Enforcement Teams working in Toronto; and
- Securities regulators, across Canada and internationally, work together more cooperatively and efficiently than ever before.

Using a risk-based approach, the Enforcement Branch employs standardized case-selection criteria to determine, consistently and objectively, the most likely instances of serious misconduct. For example, staff consider criteria such as the detrimental impact on the markets caused by different types of activities. The overall goal is to continue to improve the OSC's investigation process in order to ensure fair, vigorous and timely enforcement.

**The guidelines confirm  
that the current practices  
are designed to protect  
investors and promote  
confidence in our  
capital markets.**

This process benefits the OSC's constituents because the Enforcement Branch applies increased scrutiny to activities that pose greater potential risk to the marketplace, reviewing them more frequently and in more detail. The system also produces a fairer result for the majority of market participants who conduct effective compliance and disclosure practices.

Supporting this approach is the increasing level of cooperation on enforcement work within the OSC, where the use of multi-Branch teams has become routine in enforcement investigations. The Mutual Fund Probe is an excellent example of deploying an efficient, multi-disciplinary strategy (see page 12). Moreover, the OSC's team focus to enforcement has allowed the organization to adapt to a dynamic marketplace, to ensure protection is provided to investors and to foster fair and efficient capital markets.

## Simplified Process

In December, 2004, a new process was launched for OSC staff to prioritize, investigate and bring to a hearing quickly cases where there is a clear breach of securities law. The "Simplified Process" initiative, a joint endeavour by the Enforcement and Corporate Finance Branches, was adopted for cases that do not require extensive investigation.

Simplified process investigations involve cases where the facts are straightforward and the misconduct easily identified and essentially proved by easily obtainable documentary evidence, such as missed filing deadlines or

## Enforcement Highlights

- Andrew Rankin: On July 15, 2005, Judge Ramez Khawly of the Ontario Court of Justice found Andrew Rankin guilty on 10 charges of tipping, contrary to the Ontario *Securities Act*. The case involved the biggest insider trading investigation in Canadian history. Mr. Rankin is scheduled to be sentenced on October 19, 2005.
- Hollinger: In March, 2005, the OSC issued a notice of hearing and statement of allegations against Hollinger Inc., Conrad M. Black, F. David Radler, John A. Boulbee, and Peter Y. Atkinson over several allegations, including those related to diversion of funds, non-compliance with continuous disclosure obligations, misstatements and omissions in filings and failure to disclose the interest of insiders in material transactions.
- Norshield: In June, 2005, the OSC obtained a court order appointing RSM Richter Inc. the receiver of the Norshield Group in Ontario. Following a request from the OSC later that month, the Autorité des marchés financiers obtained a court order appointing RSM Richter the receiver of the Norshield Group in Quebec.
- Visa Gold: In March, 2005, following a referral by the RCMP, the OSC alleged trading violations by six individuals in shares of Visa Gold Explorations Inc.

failure to obtain required registration. Once identified, such cases will be brought swiftly to a hearing.

The accelerated procedure will free up resources within the OSC and contribute to a faster, stronger enforcement presence in Ontario's capital markets. Once a hearing commences before the Commission, all of the normal rules, procedures and protections afforded to respondents continue to apply.

Among the initial cases brought to a hearing, one involved a firm that failed to file prospectus supplements for distributions of certain debt securities. Another case involved a chartered accountant found to have issued auditors' reports for six publicly traded companies without being registered with the Canadian Public Accountability Board, as required under securities regulation. Both proceedings resulted in sanctions against the respondents.

## Disclosure of Investigations

As part of its commitment to transparency, the OSC published in October 2004 the guidelines that OSC staff use when deciding if it is appropriate to disclose an ongoing investigation. The objective was to assist market participants in understanding how staff chooses to disclose the existence of an investigation. 

Current practices set out that, in most circumstances, there will be no public disclosure by OSC staff of an ongoing or closed investigation to avoid prejudicing an investigation, prejudicing individuals under investigation, or where confidentiality restrictions of the *Securities Act* apply.

However, there are certain circumstances, outlined in the guidelines, when the value of disclosing an investigation outweighs any risks associated with the disclosure. Generally, it is anticipated that relevant parties will be given an opportunity to make an announcement about an investigation before OSC staff act to disclose it.

The circumstances in which an investigation may be disclosed include the need to protect investors from fraudulent behaviour such as an ongoing scam, and where related investigations are disclosed by criminal law authorities or other regulators. As a result of the guidelines, responsible issuers are becoming far more proactive in notifying investors about when the OSC is investigating affairs material to the issuer.

The guidelines confirm that the current practices are designed to protect investors and promote confidence in the capital markets.



Guidelines are available on [www.osc.gov.on.ca](http://www.osc.gov.on.ca) within Staff Notice 15-703

# Cooperation

## The Mutual Fund Probe

The OSC's probe into the trading practices of mutual funds, which concluded in March, 2005, was the biggest investigation in the history of the organization.

After conducting a multi-phase probe, the OSC entered into settlement agreements with five mutual fund managers to compensate investors who suffered harm from market-timing activities in certain affected funds. The five fund managers agreed to distribute to affected investors a total of \$205.6 million – the largest settlement in OSC history. Funds are to be distributed under the supervision of independent consultants, in accordance with a distribution plan approved by the OSC.



The Mutual Fund Probe has become a model for using a cooperative approach within the OSC

The year-long probe was a cross-branch initiative at the OSC, relying on the expertise of staff in the Capital Markets Branch, Investment Funds Branch, General Counsel's Office,

Office of the Chief Economist and Enforcement Branch. This broad, cooperative approach within the OSC – involving more than 20 staff members – will serve as a model for future investigations.

The structure of the probe featured a Steering Committee, including OSC senior management, and a Working Group, comprised of staff from each of the participating branches. Staff worked on a coordinated basis with the Mutual Fund Dealers Association of Canada (MFDA) and the Investment Dealers Association of Canada (IDA) and other provincial securities regulators. The MFDA and IDA also launched reviews of their respective members. The common goal was to look for individual cases of abuse and determine whether there were systemic problems.

The probe was a valuable exercise in how regulators must act to monitor, detect and deter abuses in today's capital markets. The investigation was successful because it was a quick response and it addressed the issue of mutual fund trading practises in its entirety. All branches of the OSC gave the probe coordinated, priority attention.

From a policy-making perspective, the OSC can build on what it learned during the probe to develop policies and suggest practices that will further strengthen the compliance culture among fund managers and improve investor protection and confidence in the industry.

## Working with Law Enforcement Agencies

The increased coordination of activities between the OSC and law enforcement agencies, both in Canada and abroad, is contributing to the effectiveness of an enforcement deterrent in the marketplace. On this front, the dynamic relationship between the OSC and the RCMP has become a model for inter-agency cooperation.

The Commission shares staff and expertise with the RCMP on the Integrated Market Enforcement Teams (IMETs), which



Probe details are available on [www.osc.gov.on.ca](http://www.osc.gov.on.ca) in the "Hot Topics" section

were launched in 2003 as a joint venture to respond to major fraud and other capital market-related crimes. There are now three IMETs located in Toronto, and two OSC staff members have been seconded to IMETs.

A number of cases that are substantially criminal in nature have been referred to IMETs by the OSC and are now under investigation. In turn, the OSC has initiated proceedings as a result of information referred by the RCMP.

In addition, two RCMP officers are part of the OSC's Joint Securities Intelligence Unit (JSIU), established five years ago to detect and disrupt criminal activity in the capital markets. The JSIU handles cases that warrant serious punitive action, and uses regulatory intelligence to detect and prevent fraud.

The OSC's cooperative approach also extends to projects involving other law enforcement agencies. A forensic accountant was seconded to support an investment-related investigation by the Ontario Provincial Police. Another OSC employee worked on secondment with the RCMP-led Greater Toronto Area Combined Forces Special Enforcement Unit (CFSEU), whose mandate is to uncover, investigate, prosecute and disrupt criminal organizations. The CFSEU is comprised of representatives of several agencies, including the Toronto Police Service, Ontario Provincial Police and the Canadian Security Intelligence Service.

These cooperative ventures point to where securities regulation enforcement is headed: more sharing of expertise and intelligence, and heightened monitoring and surveillance. Providing fair, vigorous and timely enforcement now requires a team approach that uses the full range of available regulatory resources. A proactive and coordinated approach is taking the enforcement of securities regulation in Ontario in the right direction.

## International Cooperation

Improving the level of cooperation in cross-border enforcement investigations is an important element of the OSC's contribution to Canada's role as a respected regulator in the global capital market.

By working with international securities organizations, the OSC learns from their experiences and participates in the development of global standards and practices. This, in turn, helps the OSC provide a level of protection for investors in Ontario which meets or exceeds international standards, without creating undue burdens on market participants.

Investors and other market participants are placing a greater priority on detection and prevention of securities crime. The challenge then for regulators is to establish a culture of cooperation that contributes to improved protection for investors in multiple jurisdictions.

## A proactive and coordinated approach is taking the enforcement of securities regulation in Ontario in the right direction.

In the 2004/05 fiscal year, foreign regulators, including the U.S. Securities and Exchange Commission (SEC), requested the OSC's assistance on 41 enforcement matters. OSC staff are cooperating with the SEC on a number of substantive cases.

The OSC's secondment relationships with leading regulators, including the Australian Securities and Investments Commission (ASIC), have helped the OSC better understand the enforcement challenges facing other regulators. This sharing of resources brings valuable skills, knowledge and expertise to the OSC.

From an enforcement perspective, Ontarians benefit from the OSC's cooperation with foreign regulators because Ontarians invest in capital markets that have international structures and relationships. Money does not have to clear customs, so strong cooperation is needed among regulators to bridge borders and ensure effective enforcement. It's encouraging to see a greater willingness within the international regulatory community to cooperate on securities regulation enforcement.

## Regulation

Today's securities industry has one global marketplace. Canadian corporations compete with companies around the world for sources of capital. Canadian investors buy and sell securities in an international market, seeking diversification and new opportunities for return. The OSC is addressing the changes created by a globalized marketplace by fostering competitive, cost-effective and attractive capital markets in Canada.

Significant changes have touched every aspect of the securities industry. Technological innovation in trading mechanisms is stimulating the emergence of competing marketplaces, which can create multiple pools of liquidity. This, in turn, makes it more complex to assess where to obtain the best price for a security. Concurrently, the market model is evolving toward structures that accommodate the trading of more than one asset class.

### The OSC is continually striving to improve the effectiveness and efficiency of its approach to regulatory issues.

Capital now travels more freely across borders, and the competition for it is fierce. An increasing number of Canadian corporations are seeking to raise capital from international investors, while more foreign firms are looking for sources of capital within Canada.

Investment products are becoming more sophisticated and diverse in order to meet the demands of a dynamic market. In only a few years, income trusts became a significant segment of Canada's capital market. Alternative investments have helped expand the universe of investment products and strategies and have garnered more interest from Canadian investors – both institutional and retail. The development of new investment products and services has been complemented by the technological advancements in trading and distribution systems.

The expansion of the investment universe mirrors the growth of the investor community. Currently, almost all Canadians are invested in equity markets, either indirectly through pension and mutual funds, or via direct retail investments. Canadians have a broader range of choices of investment products and services today, and the elimination of the 30% federal limit on foreign investments in registered plans in 2005 gave investors more freedom to invest around the world.

In the face of shifting market structures and emerging investment offerings, the OSC continues to pursue its objectives to provide protection to investors and foster integrity in the capital markets. As the watchdog of the public interest, the OSC has moved closer to achieving these goals by eliminating regulatory barriers to market participants and helping make complex markets more understandable for investors and public companies.

The OSC is making progress in its effort to eliminate regulatory inefficiency within the existing framework of 13 provincial and territorial securities regulators. While continuing to support the Ontario government's initiative to create a common securities regulator in Canada, the OSC is committed to working diligently with the Canadian Securities Administrators (CSA) to simplify, harmonize and streamline the system of regulation in this country, to the benefit of all market participants.

The OSC can better manage the emerging challenges of the securities industry by cooperating with market participants, industry professionals and regulatory colleagues across Canada and in other countries. The partnerships with market participants and other regulators help build on the knowledge and expertise the OSC applies to developing its rules and policies.

The OSC is continually striving to improve the effectiveness and efficiency of its approach to regulatory issues. The OSC welcomes this challenge and will continue to improve structures for compliance without creating obstacles to growth during a time of unprecedented change in the global securities marketplace.

## Investment Fund Governance

The OSC, together with the rest of the CSA, revised a proposed rule that would impose a minimum, consistent standard of governance for all publicly offered investment funds. The revised rule focuses on enhancing investor protection and would apply to publicly offered mutual funds, commodity pools, scholarship plans, labour-sponsored or venture capital funds and closed-end funds.

In May, 2005, the proposed rule (National Instrument 81-107) was published for second comment. Renamed *Independent Review Committee for Investment Funds*, it would require that every publicly offered investment fund have an Independent Review Committee (IRC) to oversee the decisions of a fund manager in situations where the manager is faced with a conflict of interest. The revised rule addresses business and structural conflicts and sets out the obligations of the manager who encounters a conflict in the administration of the fund.

The initial proposed rule was published in 2004 and the revised rule contains a number of significant differences, including:

- Existing rules and prohibitions on related-party and self-dealing transactions would be retained, not eliminated as originally proposed;
- The Rule would apply to all publicly offered investment funds, not just mutual funds; and
- The IRC would have the ability to stop a manager from proceeding with a prohibited transaction.

The proposed rule strikes a balance between management and oversight.

## Income Trusts

A fundamental principle of sound investing is that everyone who invests in securities should have access to sufficient information to make an informed decision. That principle helped guide the OSC, together with members of the CSA, in the development and implementation of a policy that provides guidance on what information income trusts should disclose.

Income trusts are sophisticated investments with distinct attributes that should be clearly disclosed, be they business income trusts, real estate investment trusts or royalty

trusts. National Policy 41-201 *Income Trusts and Other Indirect Offerings* provides guidance and clarification to market participants on how income trusts fit within the current regulatory framework. Key elements include the quality and nature of continuous disclosure records, accountability for prospectus disclosure, and liability for insider trading. Adopted in December, 2004, the policy seeks to minimize the occurrence of inconsistent interpretations and ensure the preservation of the intent of the regulatory requirements.

The OSC believes National Policy 41-201 is a source of useful guidance to issuers and will improve the quality of information available to investors, thereby contributing significantly to protecting investors and fostering the integrity of capital markets.

## Registration Reform Project

The Registration Reform Project (RRP) was created in 2004 as an umbrella initiative of the CSA to harmonize, streamline and modernize registration processes. Its goal is to create a registration regime that increases administrative efficiencies and reduces the regulatory burden.

The RRP's steering committee, chaired by the OSC, includes representatives from the industry, the Investment Dealers Association of Canada, the Mutual Fund Dealers Association of Canada, and securities regulators in British Columbia, Alberta and Quebec. In June, 2005, the RRP website was launched as a resource for the public. [www.rrp-info.ca](http://www.rrp-info.ca)

The RRP's first major phase, the National Registration System (NRS), was initiated in April, 2005. The NRS allows a firm or individual to apply for registration in multiple jurisdictions yet deal with only one regulator – the principal regulator. The applicant is required to meet the "fit and proper" standards of only the principal regulator.

The NRS will provide applicants with a single point of contact with regulators, streamlining regulatory decision-making.

One future objective is to implement a national rule to harmonize the registration requirements currently found throughout the CSA jurisdictions. The RRP also encompasses an initiative to implement the core principles of the proposed Fair Dealing Model and staged changes to the National Registration Database.



Visit the RRP website:  
[www.rrp-info.ca](http://www.rrp-info.ca)

## Initiatives

### Corporate Governance Guidelines

The OSC and other members of the CSA published guidelines on corporate governance practices in June, 2005, applicable to all reporting issuers, other than investment funds. The guidelines (National Policy 58-201) were formulated to be sensitive to the realities of small companies and controlled companies, and to take into account the impact of corporate governance developments around the world. Issuers are asked to review the guidelines in developing their own practices. The related National Instrument 58-101 *Disclosure of Corporate Governance Practices* is designed to provide greater transparency on the governance practices of issuers.

**In the face of shifting market structures and emerging investment offerings, the OSC continues to pursue its objectives to provide protection to investors and foster integrity in the capital markets.**

### Investment Funds Continuous Disclosure

The OSC led a project to harmonize the continuous disclosure (CD) requirements for investment funds among jurisdictions of the CSA. A nationally harmonized set of CD requirements, released in March 2005 and effective June 1, 2005, replaced most existing local requirements. The harmonized requirements set out the obligations with respect to financial reporting, delivery obligations, proxy voting disclosure, material change reporting and certain other CD-related matters. These requirements are set out in National Instrument 81-106 *Investment Fund Continuous Disclosure* and its related Form and Companion Policy.

### Proposed Internal Control Rule

The OSC reached agreement with other CSA members to publish for comment a proposed new internal control rule for TSX-listed issuers. The measure involves the quality of processes that a public company uses to provide assurances of the

reliability and accuracy of its published financial information. The proposed rule (Multilateral Instrument 52-111 *Reporting on Internal Control over Financial Reporting*) would require management of a reporting issuer to evaluate and report annually on the effectiveness of the company's internal control over financial reporting. Multilateral Instrument 52-111 was published for comment in February, 2005.

### Prospectus and Registration Exemptions

The new National Instrument 45-106 *Prospectus and Registration Exemptions* came into force on September 14, 2005. The rule harmonizes, streamlines and modernizes many prospectus and registration exemptions in Canada. Prior to the rule, most Canadian jurisdictions had similar, but

not identical, exemptions and, if an issuer wanted to complete a private placement in more than one province, it needed to analyze the exemptions regime in each province.

### Best Execution and Soft Dollar Arrangements

Issues related to the best execution of client orders are the subject of debate among regulators, market participants and investors around the world. With the globalization of capital markets and development of new trading systems, best execution is a more complex process. Within this context, issues are also raised about whether best execution is obtained when soft dollar arrangements are in place. In addition, the appropriateness of certain forms of soft dollar arrangements as well as transparency with respect thereto has attracted increased attention from regulators internationally. The OSC is seeking clarity in defining best execution and is working to ensure there is an appropriate regulatory framework in place to support it. In February, 2005, the OSC, along with regulators in British Columbia, Alberta, Manitoba and Quebec, published a concept paper to assess whether there is a consistent understanding of best execution.

### Removal of Foreign Content Restrictions on Registered Plans

The federal government eliminated the 30% limit on foreign content in registered plans in 2005. This created implications

for managers of 'RSP clone mutual funds', which could exceed the 30% limit. Industry stakeholders asked OSC staff to clarify certain issues stemming from the change. After consultations, the OSC published CSA Staff Notice 81-314 in March, 2005 to give guidance on the closing out of forward contracts in certain RSP funds. Many fund managers are in the process of terminating or merging RSP funds and the OSC is working to provide appropriate regulatory relief to facilitate the efficient closure of these funds.

#### *Investment Funds Section on OSC Website*

To keep pace with the information needs of market participants in the investment fund industry, the OSC added an 'Investment Funds' section to its website in April 2005. The section provides market participants and investors with up-to-date information about a wide range of topics. For example, the 'Laws and Rules' section features a listing of the main laws and rules that apply to investment funds in Ontario. The 'Staff Notices & Guidelines' section is used to periodically release guidance and notices to clarify interpretations of laws and rules, and to advise stakeholders on trends in the regulation of funds.

#### *Limited Market Dealers*

In May, 2005, the Compliance Team of the OSC's Capital Markets Branch launched the first phase in a plan to enhance the oversight of limited market dealers (LMDs). The OSC sent a survey to all LMDs to broaden its understanding of this registration category and to assist in selecting LMDs

for review as part of a focussed review of LMDs scheduled for the fall of 2005.

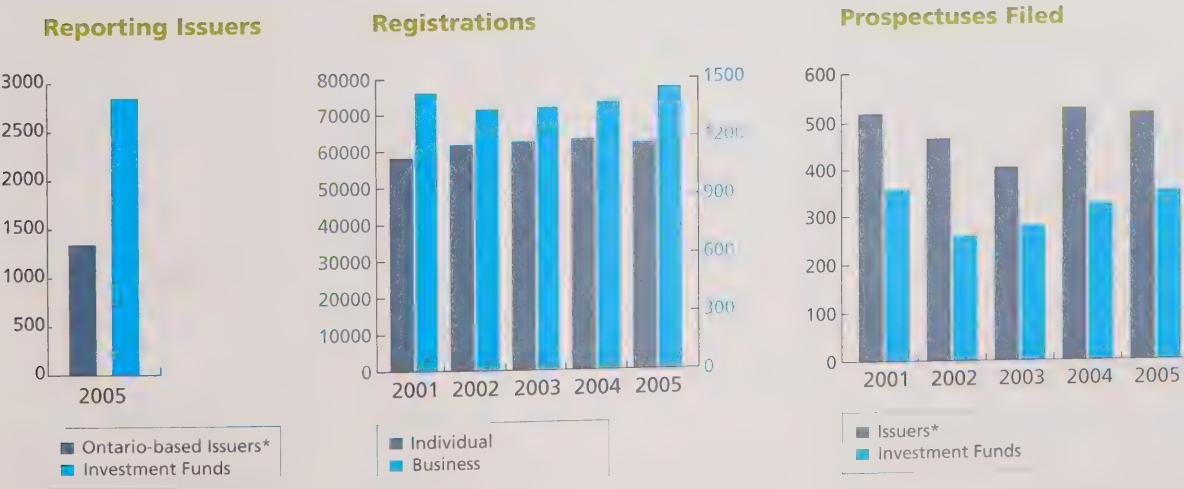
#### *Trade Reporting and Electronic Audit Trail System*

Innovations in technology have transformed how securities are traded in Canada. As market structures evolve, regulators want be able to use available technology to foster integrity and market efficiency for multiple marketplaces, where all participants have access to information to minimize the impact of market fragmentation. The OSC is the lead securities regulator on the Trade Reporting Electronic Audit Trail System initiative, or TREATS project, whose objective is to increase integrity by implementing electronic audit trail requirements to ensure dealers electronically record and transmit trade and order data to regulators for processing.

#### *Short Form Prospectus System*

A national instrument is now being finalized that will allow almost all non-IPO prospectus offerings by Canadian-listed issuers to be completed using a short-form prospectus. This would eliminate a significant burden for issuers. Specifically, the instrument eliminates the minimum market capitalization and the twelve-month seasoning requirements for short-form offerings. The instrument also eliminates duplication and inconsistencies between the short-form prospectus system and the continuous disclosure requirements, thereby better integrating the disclosure regimes for the primary and secondary markets.

Fiscal year ending March 31, 2005



## Structure

To effectively carry out its mandate, the OSC is organized into two separate areas: Commission and staff. The appointed members of the Commission serve as the OSC's governing body, offering expertise, insight and diverse perspectives, as well as a broad knowledge of how capital markets function. The staff perform the various duties necessary for the efficient and effective daily operations of the OSC, within the terms of its mandate.

The OSC is organized into 10 Branches/Offices. There are four operational Branches – Capital Markets, Corporate Finance, Enforcement and Investment Funds – with the remaining providing various support and services. Staff report into the Executive Director, with the exception of the Office of the Secretary and the Senior Advisor, International Affairs, which report directly to the OSC's Chair and Vice-Chair, respectively. The Executive Director, in turn, reports to the Chair and sits on the OSC's Executive Committee.



# Commitment

## Our Service Commitment

The mandate of the Ontario Securities Commission is to provide protection to investors from unfair, improper or fraudulent practices and to foster fair and efficient capital markets and confidence in their integrity. We commit to delivering dependable, prompt and high-quality services. Our focus is on service excellence as measured against objective standards.

### Accessibility

We make it easy for you to contact us, and offer equal access to our services. We serve you in the official language of your choice.

### Respectfulness

We treat you with courtesy and respect. We recognize your needs and rights.

### Fairness

We are unbiased and thorough in all our decision-making processes. We strive to apply all rules and decisions fairly and consistently.

### Flexibility

We are innovative and flexible when addressing issues while balancing your needs with the public interest.

### Consultation

We request and consider your views when developing policy, including your views on how the policy should be implemented.

### Responsiveness

We have service standards against which you can measure our performance. We are constantly striving to improve our standards and will seek your views on what works well and what we need to improve.

## How We Back Up Our Commitment

If you feel we have not lived up to our service commitment, please let us know. You may speak directly to the staff member with whom you were dealing or you may contact any member of our management team, including the Executive Director. No matter which person you choose to speak with, your decision will not influence our ability to be fair. If we make a mistake, we commit to set things right.



For Contact Information, see page 25

# Organization



Randee Pavalow  
Director, Capital Markets

## Capital Markets

The Capital Markets Branch administers the regulatory framework for the operation of dealers, advisers, markets and self-regulatory organizations. It consists of three teams: Registrant Regulation, Compliance and Market Regulation. The Registrant Regulation team administers requirements and evaluates applications from firms and individuals seeking to trade or advise in Ontario. The Compliance team performs sweeps of market participants and conducts reviews of fund managers and advisers to identify and resolve issues and ensure compliance with securities laws. The Market Regulation team oversees exchanges, other markets, clearing and settlement agencies and self-regulatory organizations, and deals with derivatives issues.



Margo Paul  
Director, Corporate Finance

## Corporate Finance

The Corporate Finance Branch is responsible for administering the regulation of public companies. Staff oversees public offerings of securities through a review of prospectuses, and the ongoing dissemination of information by reporting issuers through a review of their continuous disclosure documents. The Branch also monitors compliance with securities laws in takeover bids and mergers and acquisitions. The Branch has taken a leading role in the development of regulatory approaches to corporate governance, is responsible for exempt market regulation and, generally, takes the lead on all issuer-related policy initiatives.



Susan Silma  
Director, Investment Funds

## Investment Funds

The Investment Funds Branch administers the regulatory framework for investment funds in Ontario through prospectus reviews and exemption applications. The Branch regulates the offering of conventional mutual funds, exchange-traded funds, structured products, labour sponsored funds, scholarship plans and other investment funds. Staff also develops new rules and policies to adapt to the changing environment in the investment fund industry, and provides guidance to market participants to clarify interpretations of laws and rules.



Michael Watson  
Director, Enforcement

## Enforcement

With the objective of providing protection to investors and promoting market integrity, the Enforcement Branch ensures that Ontario securities laws are upheld through equitable and effective enforcement. The Branch's Surveillance and Case Assessment Teams generate and evaluate leads on potential violations, and determine whether they warrant referral to the Investigations Team for more detailed review. The Litigation Team initiates and conducts formal proceedings against alleged violators.



Wendy Dey  
Director, Communications  
& Public Affairs

## Communications & Public Affairs

The Communications Branch works closely with the Chair's Office and Commission branches to provide strategic communications advice and counsel and to ensure that all OSC stakeholders are kept well informed of Commission activities and policies. Responsibilities of the Communications Branch include management of media relations, executive speeches, investor communications, public inquiries and complaints, special events, publications and the OSC website.



Ken Gibson  
Director, Corporate Services

## Corporate Services

The Corporate Services Branch builds and maintains the core internal systems and infrastructure necessary for OSC staff to work effectively and efficiently. The Branch's areas of responsibility include information technology, finance and accounting, business planning and reporting, records, the Commission library and office and administrative services.



Monica Kowal  
General Counsel

## General Counsel's Office

The General Counsel's Office is an in-house legal and policy resource, providing senior legal advice and assistance on operational, transactional and regulatory issues to the Executive Committee, Commission and staff. The GCO also leads policy projects — including legislative reform — and supports the branches in the policy development process.



John Carchrae  
Chief Accountant

## Office of the Chief Accountant

The Office of the Chief Accountant provides specialized advice to the Chair, the Commission, staff and market participants on financial reporting, auditing and related policy issues, particularly matters relating to the form and content of financial statements and audit reports filed with the Commission. The Chief Accountant is also responsible for overseeing the Commission's relationships with accounting and auditing standards-setters and the accounting profession nationally and internationally, as well as the Canadian Public Accountability Board.



Randall Powley  
Chief Economist

## Office of the Chief Economist

The Chief Economist and his team work with OSC staff and external stakeholders to prepare detailed cost-benefit analyses of significant policy projects, designed to help the Commission select the most appropriate course of action. In addition, the Office of the Chief Economist provides analytical support to the Chair, Commission and staff on policy and operational initiatives, engages in fundamental research on the capital markets, and seeks to foster external study of securities issues.



John Stevenson  
Secretary

## Office of the Secretary

Reporting directly to the Chair, the Office of the Secretary to the Commission is responsible for ensuring the fair, impartial and efficient operation of the Commission's administrative proceedings, reviews and appeals, providing corporate secretarial support to the Commission's Board, and administering the request for comments procedures.

# Accessibility



We are determined to meet the needs of consumers of financial services. That is an important part of our mandate – one that we are determined to fulfill.

David Brown

## OSC Investor Town Hall

Held in Toronto on May 31, 2005, the OSC's Investor Town Hall provided a forum for dialogue between regulators and retail investors. Investors had the opportunity to share their experiences and offer suggestions to a panel of regulators.

The Town Hall featured questions and comments from investors, remarks by three regulators, an ombudsman and an investor representative, plus a discussion of how the current investor complaint and arbitration systems work together. More than 400 investors attended the Town Hall, while others participated via a live Internet webcast. Most of the people in attendance were from the Toronto area, but others came from many communities across Southern Ontario, including London, Huntsville and Gloucester.

A panel was moderated by the CBC's Mike Hornbrook, with assistance from journalists James Daw of the Toronto Star and Linda Leatherdale of the Toronto Sun, and the panelists were OSC Chair David Brown, Investment Dealers Association of Canada President and CEO Joe Oliver, Canadian Banking Ombudsman Michael Lauber, Mutual Fund Dealers Association President and CEO Larry Waite and Stan Buell, President of the Small Investor Protection Association.

Individuals who attended the Town Hall made it very clear that they value accountability, transparency, fairness and effectiveness in the regulatory system. Based on what the OSC heard during the discussion, the attention of investors was focused on a number of issues:

- The challenges in navigating the complaint processes of regulators;
- A desire for timely and accessible restitution;
- The limitation period on civil actions against securities firms and advisers by aggrieved investors; and
- The need for more consultation with investors by the OSC.

On June 29, 2005, the OSC published and distributed a report on what was heard from investors at the Investor Town Hall. The report also includes input from all panelists, details about audience feedback and an update about what regulators are doing to address concerns raised at the event.

The OSC Investor Town Hall report is available in the 'Investor Town Hall' section of the OSC's website, [www.osc.gov.on.ca](http://www.osc.gov.on.ca), along with a full transcript of the Town Hall dialogue, an audio webcast, photos, and answers to questions submitted by consumers.



Visit [www.osc.gov.on.ca](http://www.osc.gov.on.ca)

## Resources for Investors

### Ontario Securities Commission (OSC)

The OSC administers and enforces securities legislation in the province of Ontario. Our mandate is to provide protection to investors from unfair, improper or fraudulent practices, and foster fair and efficient capital markets and confidence in their integrity. The OSC is charged with appropriate oversight of certain self-regulatory organizations in Ontario, including the Investment Dealers Association and Mutual Fund Dealers Association.

### The Investment Dealers Association of Canada (IDA)

The national self-regulatory organization and representative for the Canadian securities industry.

([www.ida.ca](http://www.ida.ca) / 416-364-6133)

### The Mutual Fund Dealers Association of Canada (MFDA)

The self-regulatory organization for mutual fund dealers in Canada. ([www.mfda.ca](http://www.mfda.ca) / 416-361-6332)

### The Ombudsman for Banking Services and Investments (OBSI)

An independent organization that investigates customer complaints against financial services providers, including banks and other deposit-taking organizations, investment dealers, mutual fund dealers and mutual fund companies. ([www.obsi.ca](http://www.obsi.ca) / 1-888-451-4519)

## OSC Inquiries & Contact Centre

The OSC Inquiries & Contact Centre responds to those contacting us by e-mail or telephone, and handles initial reviews of written complaints against registrants and public companies:

[inquiries@osc.gov.on.ca](mailto:inquiries@osc.gov.on.ca) or  
(416) 593-8314 or toll-free at 1-877-785-1555,  
from 8:30 a.m. to 5:00 p.m. Monday to Friday  
fax: 416-593-8122

You may file a complaint using the online form in the "For the Consumer" section of [www.osc.gov.on.ca](http://www.osc.gov.on.ca). For sending tips on potential violations of Ontario securities laws: ([www.osc.gov.on.ca/Tips/tips\\_form.jsp](http://www.osc.gov.on.ca/Tips/tips_form.jsp)).

### Ontario Securities Commission

20 Queen Street West, Suite 1903  
Toronto ON M5H 3S8

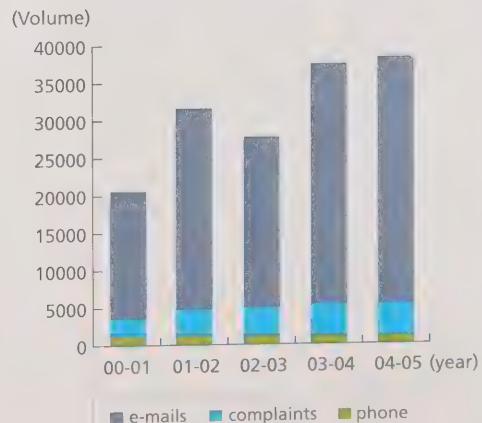
### Information Sources for Investors



The investor has access to several organizations from whom they can receive investment information and resources.

### OSC Total Contacts Received

April 1, 2004 to March 31, 2005



# Management's Discussion and Analysis

The financial statements present the results of the Ontario Securities Commission (OSC) for the year ended March 31, 2005 with 2004 comparatives and accompanying notes. Unless otherwise specified, references to years, for example 2004, refer to the fiscal years of the OSC ended March 31. The following comments analyse the factors which affected the OSC's operations during 2005 as well as the factors that reasonably may be expected to affect future operations and results.

This document should be read in conjunction with the financial statements. Certain statements included in this annual report are forward looking and are subject to important risks and uncertainties. The results or events predicted in these statements may differ materially from actual results or events. Factors which could cause results or events to differ from current expectations are described in the risks and uncertainties section. Readers should note that some assumptions, although reasonable at the time of publication, are not guarantees of future performance.

## Overview

The Ontario Securities Commission is a corporation without share capital. The OSC functions as an independent regulatory agency and administrative tribunal responsible for overseeing the securities industry in Ontario. As a Crown corporation, the OSC is exempt from income taxes. The OSC's operations are funded through fees paid by securities market participants. Employee compensation and occupancy costs account for 78.4% of OSC expenditures.

The *Securities Act* requires the OSC to complete a Memorandum of Understanding with the responsible Minister to outline the ongoing roles, responsibilities and accountability relationships between the two parties. The OSC and the Minister of Finance signed a Memorandum of Understanding in May 2003. This Memorandum of Understanding was affirmed on November 3, 2004 by the new Minister responsible for the OSC.

The OSC maintains accounting and internal control systems to provide reasonable assurance that its financial information is complete, reliable and accurate and that its assets are adequately protected. The Board of Directors, in conjunction with the Audit and Finance committee, has an oversight role to ensure the integrity of the reported information.

## Analysis of Operating Results

### *Excess of Revenue over Expenditures*

Excess of revenue over expenditures for 2005 was \$4.1 million (2004 – \$21.6 million). This is the net result following a \$14.9 million rebate of fees to market participants. The general operating surplus as at March 31, 2005 was \$32.8 million (2004 – \$28.7 million).

### *Actual Results Compared to Budget*

Our budget forecast was for an excess of revenue over expenditures of \$6.2 million in 2005. Our actual excess was \$4.1 million. Revenues were \$13.4 million higher than budget, but this was more than offset by a rebate of fees of \$14.9 million and expenses were \$0.5 million more than budget.

### *2005 Actual versus Budget*

	Actual	Budget	Variance	Variance
			Favourable/(Unfavourable)	
Revenues	\$ 80,690,664	\$ 67,294,000	\$ 13,396,664	19.9%
Rebate of fees	(14,935,360)	–	(14,935,360)	N/A
Revenues (net of rebate of fees)	65,755,304	67,294,000	(1,538,696)	(2.3%)
Expenses	61,629,237	61,134,000	(495,237)	(0.8%)
Excess of Revenue	\$ 4,126,067	\$ 6,160,000	\$ (2,033,933)	(33.0%)
Capital Expenditures	\$ 2,052,416	\$ 1,680,000	\$ (372,416)	(22.2%)

## Revenue

The OSC introduced a new, restructured fee schedule effective March 31, 2003. A primary objective of the new schedule was to ensure that the fees more accurately reflect the OSC's cost of providing services to market participants. The fee schedule requires the payment of "participation fees" and "activity fees".

Participation fees are designed to reflect the benefit derived by market participants from participating in Ontario's capital markets. Reporting issuers, registrant firms and unregistered investment fund managers are required to pay participation fees annually. Participation fees replace most of the continuous disclosure filing fees and other activity fees charged to market participants under the previous fee regime. The participation fee is based on a measure of the market participant's size, which is intended to serve as a proxy for the market participant's use of the Ontario capital markets. The amounts of the participation fees are based on the cost of a broad range of regulatory services that cannot be practically or easily attributed to individual activities or entities. Participation fee levels are based on a tiered structure. As the market size of a market participant increases, they move through various tiers which have increasingly higher fees. The breadth of the tiers is set sufficiently wide to minimize movement through tiers due to market fluctuations. This tiered design limits volatility in OSC revenues due to market changes.

Activity fees are designed to represent the direct cost of OSC staff resources used in undertaking certain activities requested of staff by market participants; for example, the review of prospectuses and applications for discretionary relief or the processing of registration documents. Activity fees are charged only for tasks undertaken by staff at the

request of the market participant. Activity fees are charged for a limited number of activities only and are flat rates based on the average cost to the OSC of providing the service.

The *Securities Act* states that, when ordered to do so by the responsible Minister, the OSC shall pay into the Consolidated Revenue Fund such of its surplus funds as determined by the Minister. The Minister has confirmed that the OSC is no longer required to remit its surpluses. Any deficits will be funded either through surpluses previously generated or generated in the future, or from the OSC's reserve. Under the new fee model, the OSC plans to set fee levels every three years. Fees will be adjusted to offset accumulated deficits or surpluses. Since the introduction of the revised fee structure, the OSC has collected more fees than anticipated. In an effort to expedite the return of surplus to the market participants who funded it, the Commission authorized a one-time rebate of fees of \$14.9 million which was paid in March 2005.

Figure 1 – OSC Fees by Type



In 2005, total fees collected under the *Securities Act* and the *Commodity Futures Act* grew by \$3.6 million or 4.8% to \$78.4 million.

	% of Total Fees	2005	2004	Change	% Change
Activity fees	15.9	\$ 12,436,046	\$ 11,765,826	\$ 670,220	5.7
Participation fees	81.4	63,833,602	33,880,566	29,953,036	88.4
Transitional fees	0.2	175,146	26,826,132	(26,650,986)	-99.3
Late fees	2.5	2,000,030	2,382,418	(382,388)	-16.1
Total fees	100.0	78,444,824	74,854,942	3,589,882	4.8
Rebate of fees		(14,935,360)	–	(14,935,360)	N/A
Investment income		1,534,933	1,672,727	(137,794)	-8.2
Miscellaneous		710,907	84,973	625,934	736.6
Total revenues		\$ 65,755,304	\$ 76,612,642	\$ (10,857,338)	-14.2

# Management's Discussion and Analysis

## Fees

*Activity fees* accounted for 15.9% of total fees. Activity fees for issuers rose 16.5% or \$1.3 million due to growth in applications under Rule 45-501 (Exempt Distributions). Activity fees for registrants fell 17.5% or \$654K mainly due to fewer registrations of officers and new directors. Activity fees reflect the cost of providing various services (registration, applications for exemption, prospectus review etc.) to market participants. The fees have been set to recover the costs incurred by the OSC to provide each service. Activity fee volumes are the most variable component of our fees.

*Participation fees* are the largest revenue source, accounting for 81.4% of fees. Actual fees collected exceeded budget by \$10.4 million. National Instrument 51-102 became effective in April 2004. The rule reduced the amount of time for filings by larger issuers from 140 to 90 days. The transition to the shorter filing time resulted in a one-time revenue impact as some issuers paid participation fees twice during 2005. Registrant participation fees rose by 15% to \$25.9 million. Two factors explain this increase, growth in the size of firms, which generates higher fees, and a 12% increase in the number of firms registered.

*Transitional fees* pertained to some fees still due under the previous fee schedule (e.g., remaining fees related to mutual fund prospectus proceeds) or that occurred in situations where market participants were required to make partial year payments as part of the transition to the new fee schedule. Transitional fees declined from 35.8% of total fees in 2004 to 0.2% of fees, or \$175K, as the period for transition to the new fee schedule ended.

*Late fees* accounted for 2.5% of fees. These fees were established to encourage timely regulatory filings (such as insider reports) and are expected to decline over time. Fees collected declined by 16% to \$2.0 million (2004 – \$2.4 million) but still exceeded budget by \$1.0 million. Fees for late SEDI insider filings generated 56% of total late fees. The total number of transactions decreased reflecting improved compliance with filing timelines.

## Other Revenue

*Investment income* generated by deposits and other investments declined 8.2% to \$1.5 million. The negative impact of lower interest rates more than offset the impact of higher than expected cash balances. Interest on cash balances generated \$715K (2004 – \$659K). These balances earn interest at a rate of 1.75% below the prime rate or 0.25% below bankers' acceptance. Investments in short and

mid term instruments with the Ontario Financing Authority generated \$820K (2004 – \$1.0 million). The average rate of return on these instruments was 2.57% which was 54 basis points lower than in 2004.

*Miscellaneous fees* grew from \$85K to \$711K. Key components of the increase were \$456K received from the Autorité des marchés financiers for their portion of the NRD contribution made in 2003 and \$138K in royalties from the publisher of the OSC Bulletin.

## Expenses

Total expenses for 2005 (Figure 2) increased 12.1% to \$61.6 million (2004 – \$55.0 million) against a budget of \$61.1 million.

### 2005 Actual versus 2005 Budget

Salaries and benefit spending exceeded budget by \$54K. However, salaries and benefit spending would have been significantly under budget had \$1.2 million in unbudgeted severance costs not occurred. The OSC recovered \$456K less in enforcement costs than expected. Expenses recovered as part of enforcement settlements are recorded as an offset to salaries and benefits and professional services, depending on the nature of costs recovered. The OSC made a \$1.0 million payment to develop enhancements that will make the SEDI system more user friendly. This payment was not anticipated at the time the budget was set.

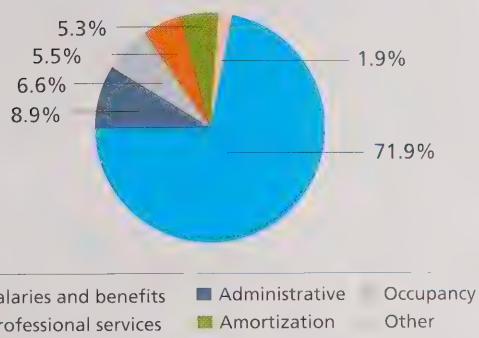
Offsetting these areas where spending exceeded budget were the following areas where spending was lower than anticipated:

- training (\$239K) and travel (\$237K) were lower, as planned activities were deferred due to other workload priorities;
- Commission expenses (\$130K), as hearing activity was lower than planned and delays occurred in filling Commissioner vacancies;
- communications spending (\$318K) on shared CSA investor education initiatives was deferred due to budget constraints in other jurisdictions. Translation of our website was also slower than expected;
- lower than planned professional services spending (\$544K) occurred because contingencies for CSA shared projects were not used, costs to conduct lease negotiations were below budget, and funds budgeted for work on mutual fund governance were not required as this project ended up being completed late in 2004.

## 2005 Actual versus 2004 Actual

	% of Total Expenses	2005	2004	Change	% Change
Salaries and benefits	71.9	\$ 44,286,613	\$ 40,147,154	\$ 4,139,459	10.3
Administrative	8.9	5,461,581	4,561,661	899,920	19.7
Occupancy	6.6	4,036,881	3,972,891	63,990	1.6
Professional services	5.5	3,419,175	1,957,490	1,461,685	74.7
Amortization	5.3	3,266,928	3,233,401	33,527	1.0
Other	1.9	1,158,059	1,098,577	59,482	5.4
Total expenses	100.0	\$ 61,629,237	\$ 54,971,174	\$ 6,658,063	12.1

**Figure 2 – OSC Expenses by Type**



The key contributors to the expenditure increase were as follows:

*Salaries and Benefits* costs increased by 10.3% to \$44.3 million (2004 – \$40.2 million) and accounted for 71.9% of the OSC's total expenditures. Key contributors to this increase were annual salary adjustments (\$1.4 million), higher benefits costs (\$550K), increased staffing levels (\$700K million) and higher severance costs (\$1.2 million). The OSC had 376 permanent employees on board (9.4% positions vacant) at the end of the year compared to 352 (10.9% positions vacant) at the end of 2004.

*Administrative* costs accounted for 8.9% (2004 – 8.3%) of the OSC's total expenditures. Expenditures on administrative costs increased by 19.7% to \$5.5 million (2004 – \$4.6 million). Spending for training increased by 40% to \$662K (2004 – \$470K). Mutual Reliance Review System (MRRS) training, which occurs with CSA counterparts every other year, accounted for one third of the increase. Management skills training programs were completed and overall staff participation levels in training increased. Commission related

expenses rose 19% to \$758K (2004 – \$635K). The number of proceedings before the Commission increased by one to thirty-one. The number of hearing days increased 37% to eighty-two (2004 – 60). During 2005, two vacant Commissioner positions were filled resulting in higher costs. Communications costs were 20% lower at \$1.2 million (2004 – \$1.5 million). Savings occurred due to a decision to reduce the use of the Ontario Gazette and communicate more through our website, lower costs for CSA shared investor education initiatives, and reductions in stakeholder surveys and printing and postage. A \$1.0 million payment was made to CDS towards improving the SEDI user interface.

*Professional Services* costs increased 74.7% from \$2.0 million to \$3.4 million and accounted for 5.5% (2004 – 3.6%) of the OSC's total expenditures.

	(\$ millions)	
	2005	2004
Actual costs	3.7	3.0
Recoveries of costs	0.3	1.0
Net Professional Services	3.4	2.0

The increase in actual costs related to increased enforcement work. Approximately \$1 million in net professional services was for enforcement-related matters including the use of specialized external legal and forensic accounting resources.

The OSC is a member of the Canadian Securities Administrators (CSA), which is a forum composed of provincial securities regulators. Total CSA spending on projects was \$1.9 million in 2005 (2004 – \$1.8 million), of which the OSC contributed \$755K (2004 – \$854K). Professional services include costs to operate CSA offices (allocated on a formula basis) as well as our portion of costs for all professional services costs incurred on joint CSA projects.

# Management's Discussion and Analysis

A central secretariat co-ordinates all CSA projects, including the development of harmonized securities policies and rules. A CSA systems office has also been established to manage the CSA's business relationships with third party technology providers. In 2005, the OSC contributed \$175K (2004 – \$38K) to the cost of the CSA Secretariat and \$208K (2004 – \$119K) to the cost of the systems office.

Key initiatives funded through this process included:

National Registration System	\$68K
Uniform securities transfer legislation	\$63K
Joint Forum initiatives	\$39K
Investor education initiatives	\$36K
National cease trade order system	\$36K
Straight through processing	\$32K

Amortization costs accounted for approximately 5.3% (2004 – 5.9%) of the OSC's total expenses. Amortization expenses increased to \$3.3 million (2004 – \$3.2 million).

Occupancy costs accounted for approximately 6.6% (2004 – 7.2%) of the OSC's total expenditures. Expenditures on occupancy increased \$64K or 1.6% to \$4.0 million.

Other costs, which reflect travel and related expenses, increased \$59K or 5.4% to \$1.2 million and accounted for 1.9% (2004 – 2.0%) of the OSC's total expenditures. Increased costs to support our international work with IOSCO were the main source of this increase.

## Liquidity and Financial Position

### Liquidity

The OSC has sufficient liquidity to finance its operations and capital purchases. Our cash position improved by \$5.9 million in 2005. Cash flows from operations were \$7.4 million. Purchases of capital assets used \$2.1 million.

As at March 31, 2005, the OSC held \$36.6 million (2004 – \$30.7 million) in cash, had current assets of \$38.4 million (2004 – \$32.5 million) and current liabilities of \$8.4 million (2004 – \$8.1 million) for a current ratio of 4.6:1 (2004 – 4.5:1). Our general surplus increased by \$4.1 million, reflecting our excess revenues over expenses.

### Accounts receivable

Accounts receivable rose \$59K to \$1.5 million. Outstanding late fees increased 17.0% to \$936K (2004 – \$800K) and accounted for 67% of accounts receivable. Other key receivables are \$377K (2004 – \$388K) interest receivable and \$120K from the Investor Education Fund (2004 – \$106K).

### Reserve

The new OSC fee structure has reduced the potential for significant fluctuations in revenues arising from market volatility. Revenue generation remains a source of risk for the OSC as all revenues are still correlated to market activity to some extent. To manage this uncertainty, the OSC has a \$20 million reserve as an operating contingency for revenue shortfalls or unexpected expenditures. The OSC has an additional \$12 million reserve that may only be used to offset costs incurred related to the proposed merger of the OSC with the Financial Services Commission of Ontario.

The rate of return on investments is low as the funds are invested in treasury bills. The prime investment consideration for the reserve is the protection of capital and the appropriate liquidity to meet unanticipated cash flow needs. The OSC takes income generated by the reserve into general operations.

### Capital transactions

Capital expenditures of \$2.1 million (2004 – \$1.4 million) were made during 2005. About two thirds of the purchases were technology related (\$1.4 million), including equipment purchased for increased staff complement and replacement of computer equipment to ensure the currency of our technology base. The balance of capital spending was on leasehold improvements and furniture for additions to and consolidation of our leased space. Capital assets declined 23% to \$4.0 million as amortization exceeded capital additions by \$1.2 million.

### Liabilities

Accounts payable and accrued liabilities increased 4.5% to \$8.4 million (2004 – \$8.1 million). Key accrual increases included general payables (\$869K), bonuses and severance (\$745K) and vacations (\$113K). The key offset was a \$1.1 million reduction in our payroll accrual which reflected fewer work days to accrue for.

The accrued benefit liability represents future obligations relating to supplementary pension plans. The unfunded supplemental pension plans had an accrued benefit obligation of \$967K (2004 – \$735K) at March 31, 2005. The OSC's related expense for the year was \$187K (2004 – \$115K) and is included in salaries and benefits. The increase reflects full versus partial year costs for a Vice Chair in 2005.

In support of the development of the Mutual Fund Dealers Association (MFDA), the OSC guaranteed 61% of a total \$12 million line of credit as assistance during start-up of MFDA operations. The Alberta Securities Commission and the British Columbia Securities Commission also guaranteed

a specific percentage of the total indebtedness. As the MFDA is now fully operational, a release from the loan guarantee was obtained November 26, 2004.

#### **Designated settlements**

In 2005, the OSC approved \$787K in designated settlements arising from enforcement proceedings. Designated settlement funds are allocated to or for the benefit of third parties such as the Investor Education Fund which the Commission established five years ago. Its objectives are to increase knowledge and awareness among investors and potential investors and to support research and develop programs and partnerships which promote investor education. A Board of Directors governs the Investor Education Fund and is responsible for developing criteria for, and approving, the disbursement of funds.

The OSC currently holds \$2.5 million in designated settlements. Amendments to the *Securities Act* in December 2004 removed the requirement for Ministerial approval of allocations of designated settlement funds. The Minister retained the right to impose guidelines for the allocation process. Allocation of all designated settlements exceeding \$1 million that were collected before the amendment, continue to require approval from the Minister. The OSC is currently seeking Ministerial approval to transfer these designated settlement balances to third parties.

#### **Funds in trust, CSA**

During the year, the Commission received \$5,943,687 from the operator of the SEDAR electronic filing system, representing the accumulated surplus from the operations of SEDAR from its inception. Interest earned on these funds was \$55,098. These funds are to be held by the Commission in accordance with agreements amongst the Commission, the Alberta Securities Commission, the British Columbia Securities Commission and L'Autorité des marchés financiers, and shall be used towards one or more of the following actions:

- development or enhancement of SEDAR;
- development or enhancement of the System of Electronic Disclosure by Insiders;
- to permit a reduction in the SEDAR Fee Schedule;
- for application towards a previous year's shortfall.

## **Risks and Uncertainties**

#### **People risk**

As a knowledge-based entity our ability to attract and retain people is critical to our success. We track a range of measures (e.g., turnover, compensation surveys) to manage this risk. Knowledge management is a key focus and we continue to pursue initiatives to improve our ability to retain corporate memory and to ensure effective knowledge transfer.

#### **Systems risk**

Controlling access to our data is a critical component of our operations. Given the nature of the data stored by the OSC, the risk of external parties accessing our data is an important and ongoing challenge. We regularly review our systems security measures to identify potential vulnerabilities. External vendors experienced in gaining access to internal computer systems are periodically contracted to test our internal and external system security measures.

#### **Business continuity**

The OSC has a Business Continuity Plan (BCP) to ensure the continuation of critical regulatory services should the OSC face a significant disruption to its operations. Detailed business continuity plans are in place for each priority business function. Each plan includes documented recovery procedures including manual workarounds and mitigation strategies. Offsite recovery services and facilities are in place and were successfully tested during 2005. We are currently finalizing our plan to include strategies to recover and resume our operations for disruptions that could render our offices unusable for an extended period.

#### **Internal audit**

The OSC has an internal audit program to identify and address key risks that could impact the achievement of our business objectives. In 2005, our third party internal auditors completed reviews of our project management and budgeting and forecasting processes. No major risk exposures were identified and implementation of the recommended process improvements is underway. Our auditors also re-assessed our risk universe and developed a new two-year audit plan based on this information. Upcoming audit projects include reviews of OSC registration processes, our enforcement case management process and our self regulatory organizations (SRO) oversight process.

# Management's Discussion and Analysis

## *Risk-based compliance*

Risk-based approaches are being used for disclosure review and compliance. As a result, fewer reviews are undertaken, but each review, on average, is carried out in more depth. Enforcement also uses a risk-based approach to ensure cases that are brought forward are subject to consistent scrutiny, involve significant breaches of Ontario securities law, and give appropriate consideration to Commission priorities.

## *National approaches to securities regulation*

The ongoing national discussions on approaches to securities regulation in Canada could have a material impact on OSC operations. Failing substantial progress toward the establishment of such a single securities regulator by October 2005, the recommendation of the Standing Committee on Finance and Economic Affairs, is for the Ontario Government to take the necessary steps to separate the adjudicative function of the Commission from its other roles. If implemented, this change would have a material impact on our operations.

## *Reliance on CDS Inc.*

CDS Inc. operates a number of major systems on behalf of the CSA and the OSC. In 2005, 90% (2004 – 90%) of fee revenue was collected through the System for Electronic Document Analysis and Retrieval (SEDAR)(54%) and the National Registration Database (NRD)(36%) systems. No material change is expected in the volume of fees collected

through these systems. CDS Inc. recovers its costs to operate these systems by charging user fees to filers.

CSA members are signing off a new operating agreement for SEDAR. The NRD system was launched on March 31, 2003. The current operating agreement for the NRD expires March 2009. The System for Electronic Disclosure by Insiders (SEDI) became fully operational in May 2003. The current operating agreement for SEDI runs until May 2010. If CDS becomes unwilling or unable to operate one or all of these systems, the OSC and the CSA will need to ensure the continued operation of these systems.

## 2005 Outlook

Our 2005/2006 Statement of Priorities sets out our priorities and proposed initiatives for the upcoming year. The document is available at [www.osc.gov.on.ca](http://www.osc.gov.on.ca). The proposed 2005/2006 budget will allow us to move toward achievement of the following goals:

- Providing vigorous, fair and timely enforcement;
- Taking actions that better reflect the needs of the retail investor;
- Promoting a harmonized, simplified securities regulatory system for Canada;
- Contributing to Canada's role as an active and respected player in the global capital market.

The 2005 – 2006 OSC budget essentially reflects a breakeven position.

## *2006 Budget versus 2005 Actual*

	2006 Budget	2005 Actual	Variance Favourable/(Unfavourable)	Variance
Revenues	\$ 67,062,000	\$ 80,690,664	\$ (13,628,664)	(16.9%)
Rebate of fees	–	(14,935,360)	14,935,360	N/A
Revenues (net of rebate of fees)	67,062,000	65,755,304	1,306,696	2.0%
Expenses	66,963,000	61,629,237	(5,333,763)	(8.7%)
Excess of Revenue	\$ 99,000	\$ 4,126,067	\$ (4,027,067)	(97.6%)
Capital	\$ 2,989,000	\$ 2,052,416	\$ (936,584)	(45.6%)

In 2005, \$80.7 million was collected in revenue before the fee rebate. OSC revenues are expected to be \$67.1 million or 17% lower in 2006. Lower revenues are expected for the following reasons:

- National instrument 51-102 reduced the due date for filings (and fee payments) by larger issuers from 140 days to 90 days. As a result, an additional \$10.4 million was collected as some issuers paid two participation fees during 2005. The impact of these double payments will not re-occur in 2006.
- Registrant participation fees are projected to fall \$800K or about 3%.
- Late fees are very difficult to predict as they are dependent solely on compliance levels of market participants. Planned improvements to SEDI are expected to assist with compliance with filing due dates. The expected impact is a \$500K reduction in late fees.
- Investment income is forecast to fall by \$200K due to reduced funds under investment.

The budget does not anticipate a material change in the level of market activity. Although our fee structure is designed to reduce the potential for significant fluctuations in revenues arising from market volatility, the potential for material market fluctuations due to world events is an ongoing source of risk that could have a negative impact on OSC revenues.

The OSC remains committed to ensuring that fees paid by issuers and registrants reflect the projected costs to regulate each group. We are currently developing a proposed fee schedule for the three year period ending 2009. We are reviewing each service activity and its related cost in order to set new activity fees. Participation fees will be set at levels to generate a cumulative deficit equal to the surplus collected from market participants as at March 31, 2006.

The OSC budgeted net operating expenditures to increase 8.7% to \$67.0 million for 2006 (2005 – \$61.6 million). The key budget increases are salaries and benefits costs of \$4.5 million and professional services of \$1.3 million.

*Salaries and benefits* costs are projected to rise 10.2% to \$48.8 million (2005 – \$44.3 million). This increase reflects the following:

- a decision to increase approved staffing from 390 to 408 including seven additional staff in enforcement and four additional staff in investment funds.
- annual performance increments to salaries of current staff, additional bonus requirements arising from staff growth and the impacts of various in-year staff changes and vacancies.
- benefits associated with the salary changes above and higher costs for our health plan.

*Administrative costs* are expected to decline by \$750K. The \$1.0M payment toward upgrading SEDI will not re-occur in 2005/2006. This decrease is offset by planned increases for various communications initiatives \$135K and staff training \$96K.

*Occupancy costs* are projected to rise 17.3% to \$4.7 million (2005 – \$4.0 million) due to higher lease-related operating costs and additional space.

*Amortization costs* are expected to decline 18.0% to \$2.7 million for 2005 (2005 – \$3.3 million) reflecting a reduced capital base.

*Professional services* costs are projected to rise 21% to \$4.1 million for 2006 (2005 – \$3.4 million). About half of the increase relates to higher expected cost for litigation support on a number of large enforcement cases. Costs for CSA shared projects are expected to rise by \$300K.

*Other expenses* are forecast to increase 16% to \$1.34 million (2005 – \$1.16 million). Increased travel costs for various CSA initiatives (Passport, Harmonized Registration) and IOSCO related travel are the key sources of the increase.

The 2006 capital budget is \$3.0 million, 46% higher than the \$2.0 million spent in 2005. Additional accommodations for new staff will require spending for leasehold improvements (\$1.0) million and related furniture (\$400K). The remaining capital expenditures are information technology-related reflecting our continued commitment to maintaining state of the art information technology capabilities.

# Management's Responsibility

Management is responsible for the integrity of the financial statements and other information presented in the annual report. The financial statements have been prepared by management in accordance with Canadian generally accepted accounting principles.

The Ontario Securities Commission is committed to full and open disclosure of its operations and maintains a system of internal controls designed to provide reasonable assurance that reliable financial information is available on a timely basis. The preparation of financial statements involves the use of estimates based on management's judgement on transactions which will conclude in future periods.

The Board of Directors ensures that management fulfills its responsibility for financial information and internal control. The financial statements have been reviewed by the Audit Committee and approved by the Board of Directors. The Auditor General's Report, which follows, outlines the scope of the Auditor's examination and opinion.



David A. Brown, Q.C.  
Chair and Chief Executive Officer

May 13, 2005

Office of the  
Auditor General  
of Ontario



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## Auditor's Report

To the Ontario Securities Commission

I have audited the balance sheet of the Ontario Securities Commission as at March 31, 2005 and the statements of operations and operating surplus and cash flows for the year then ended. These financial statements are the responsibility of the Commission's management. My responsibility is to express an opinion on these financial statements based on my audit.

I conducted my audit in accordance with Canadian generally accepted auditing standards. Those standards require that I plan and perform an audit to obtain reasonable assurance whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation.

In my opinion, these financial statements present fairly, in all material respects, the financial position of the Commission as at March 31, 2005 and the results of its operations and its cash flows for the year then ended in accordance with Canadian generally accepted accounting principles.



J. R. McCarter, CA  
Auditor General  
Toronto, Ontario  
May 13, 2005

# Balance Sheet

As at March 31, 2005

	2005	2004
<b>ASSETS</b>		
<b>CURRENT</b>		
Cash	\$ 36,588,846	\$ 30,652,492
Accounts receivable	1,486,721	1,427,708
Prepaid expenses	361,776	465,923
	38,437,343	32,546,123
DESIGNATED SETTLEMENTS (Note 3)	2,501,008	2,000,711
FUNDS IN TRUST (Note 4)	5,998,785	-
RESERVE FUND ASSETS (Note 5)	32,000,000	32,000,000
CAPITAL ASSETS (Note 6)	4,022,511	5,237,023
	\$ 82,959,647	\$ 71,783,857
<b>LIABILITIES</b>		
<b>CURRENT</b>		
Accounts payable and accrued liabilities	\$ 8,441,504	\$ 8,077,550
	8,441,504	8,077,550
<b>NON-CURRENT</b>		
Other long term liabilities (Note 7(b))	1,114,747	928,060
	9,556,251	9,005,610
DESIGNATED SETTLEMENTS (Note 3)	2,501,008	2,000,711
FUNDS IN TRUST (Note 4)	5,998,785	
<b>SURPLUS</b>		
<b>OPERATING</b>		
General (Note 8)	32,805,359	28,679,292
Reserve (Note 5)	32,000,000	32,000,000
	64,805,359	60,679,292
<b>CONTRIBUTED</b>		
	98,244	98,244
	64,903,603	60,777,536
	\$ 82,959,647	\$ 71,783,857

Investor Education Fund (Note 9)

Commitments and Contingencies (Notes 10,12)

See accompanying notes to Financial Statements.

ON BEHALF OF THE BOARD OF THE COMMISSION



David A. Brown, Q.C.  
Chair



David L. Knight, FCA  
Commissioner

# Statement of Operations and Operating Surplus

For the year ended March 31, 2005

	2005	2004
<b>REVENUE</b>		
Fees (Note 8)	\$ 78,444,824	\$ 74,854,942
Rebate of fees (Note 8)	(14,935,360)	—
Investment income	1,534,933	1,672,727
Miscellaneous	710,907	84,973
	<u>65,755,304</u>	<u>76,612,642</u>
<b>EXPENSES</b>		
Salaries and benefits (Note 11)	44,286,613	40,147,154
Administrative	5,461,581	4,561,661
Occupancy (Note 12)	4,036,881	3,972,891
Professional services (Note 11)	3,419,175	1,957,490
Amortization	3,266,928	3,233,401
Other	1,158,059	1,098,577
	<u>61,629,237</u>	<u>54,971,174</u>
<b>EXCESS OF REVENUE OVER EXPENSES</b>	<b>4,126,067</b>	<b>21,641,468</b>
<b>OPERATING SURPLUS, BEGINNING OF PERIOD</b>	<b>60,679,292</b>	<b>39,037,824</b>
<b>OPERATING SURPLUS, END OF PERIOD</b>	<b>\$ 64,805,359</b>	<b>\$ 60,679,292</b>
<b>Represented by:</b>		
General	\$ 32,805,359	\$ 28,679,292
Reserve	32,000,000	32,000,000
	<u>\$ 64,805,359</u>	<u>\$ 60,679,292</u>

See accompanying notes to Financial Statements.

# Statement of Cash Flows

For the year ended March 31, 2005

	2005	2004
<b>NET INFLOW (OUTFLOW) OF CASH RELATED TO THE FOLLOWING ACTIVITIES</b>		
Cash flows from operating activities		
Excess of revenue over expenses	\$ 4,126,067	\$ 21,641,468
Adjustments for amortization	3,266,928	3,233,401
	<u>7,392,995</u>	<u>24,874,869</u>
Changes in non-cash working capital		
Accounts receivable	(59,013)	711,897
Prepaid expenses	104,147	(64,502)
Due to Province of Ontario	-	(14,480,975)
Accounts payable and accrued liabilities	363,954	(1,777,214)
Other long term liabilities	186,687	114,929
	<u>595,775</u>	<u>(15,495,865)</u>
	<u>7,988,770</u>	<u>9,379,004</u>
Cash flows from investing activities		
Purchase of capital assets	(2,052,416)	(1,430,854)
	<u>(2,052,416)</u>	<u>(1,430,854)</u>
<b>NET INCREASE IN CASH POSITION</b>	<b>5,936,354</b>	<b>7,948,150</b>
<b>CASH POSITION, BEGINNING OF PERIOD</b>	<b>30,652,492</b>	<b>22,704,342</b>
<b>CASH POSITION, END OF PERIOD</b>	<b>\$ 36,588,846</b>	<b>\$ 30,652,492</b>

See accompanying notes to Financial Statements.

# Notes to the Financial Statements

March 31, 2005

## 1. NATURE OF THE CORPORATION

The Ontario Securities Commission (the "Commission") is a corporation without share capital and functions as an independent regulatory agency and administrative tribunal responsible for overseeing the securities industry in Ontario. As a Crown corporation, the Commission is exempt from income taxes.

## 2. SIGNIFICANT ACCOUNTING POLICIES

These financial statements have been prepared in accordance with Canadian generally accepted accounting principles. Significant accounting policies followed in the preparation of these financial statements are:

### a) Capital assets

Capital assets are recorded at cost less accumulated amortization. Amortization is calculated on a straight-line basis over the estimated useful lives of the assets, beginning in the fiscal year following acquisition, as follows:

Office furniture and equipment	5 to 10 years
Computer hardware and related applications	2 years
Leasehold improvements	over term of lease

### b) Revenue

Fees are recognized when earned which is normally upon receipt.

Recoveries of costs of investigations are recorded as offsets to the relevant expense upon date of decision, unless management determines there is significant doubt as to ultimate collection, in which case recovery is recognized when cash is received.

### c) Use of estimates

The preparation of financial statements in accordance with Canadian generally accepted accounting principles requires that management make estimates and assumptions that affect the reported amounts of assets and liabilities as at the date of the financial statements and the reported amounts of revenues and expenditures for the period. Actual amounts could differ from these estimates.

### d) Employee Benefit Plan

The Commission provides pension benefits to its full-time employees through participation in the Public Service Pension Plan, which is a multiemployer defined benefit pension plan. This plan is accounted for as a defined contribution plan, as the Commission has insufficient information to apply defined benefit plan accounting to this pension plan.

The Commission also maintains supplementary unfunded pension plans for certain full-time members as described in note 7(b). The Commission accrues its obligations and the related costs under these supplemental unfunded pension plans. The transitional obligation and actuarial gains or losses are being amortized over the average remaining service period of active members, or over the life expectancy of inactive members, expected to receive benefits under these plans. For purposes of valuation, the actuarial liability and the current service cost is determined by independent actuaries using the projected benefit method prorated on services and management's best estimate assumptions.

The costs of post-retirement non-pension benefits are not included in the Statement of Operations and Operating Surplus as described in note 13(c).

### 3. DESIGNATED SETTLEMENTS

The Commission has reached a number of settlement agreements arising from enforcement proceedings where monies from these settlements are received or receivable by the Commission to be set aside and allocated to such third parties as the Commission may determine, subject to the approval of the responsible Minister, where required. The accumulated funds are held in a segregated bank account. As at March 31, 2005, the accumulated balance is determined as follows:

	2005	2004
Opening balance	\$ 2,000,711	\$ 474
Settlements	787,105	1,999,400
Interest	46,751	1,311
Payments		
Investor Education Fund – prior period	–	(474)
Investor Education Fund – current period	(333,559)	–
Closing balance	\$ 2,501,008	\$ 2,000,711
Represented by:		
Cash	\$ 2,406,850	\$ 1,628,195
Receivables	94,158	372,516
	\$ 2,501,008	\$ 2,000,711

### 4. FUNDS HELD IN TRUST

During the year, the Commission received \$5,943,687 from the operator of the SEDAR electronic filing system, representing the accumulated surplus from the operations of SEDAR from its inception. As at March 31, 2005, interest earned on these funds was \$55,098. These funds are to be held by the Commission in accordance with agreements amongst the Commission, the Alberta Securities Commission, the British Columbia Securities Commission and L'Autorité des marchés financiers, and shall be used towards one or more of the following actions:

- i) The development or enhancement of SEDAR;
- ii) The development or enhancement of the System of Electronic Disclosure by Insiders;
- iii) To permit a reduction in the SEDAR Fee Schedule;
- iv) The application towards a previous year's Shortfall, as described in note 10.

### 5. RESERVE

- a) As part of the approval of its self-funded status, the Commission was allowed to establish a \$20.0 million reserve to be used as an operating contingency against revenue shortfalls or unanticipated expenditures. The accumulated funds, at March 31, 2005, have been invested in six month and one year treasury bills with the Ontario Financing Authority.
- b) In the May 2, 2000 Budget, the Minister of Finance announced that the Ontario Securities Commission and the Financial Services Commission of Ontario would be merged into a single agency that would provide regulation of the capital markets and financial services sectors.

Legislation is required in order to create the proposed new organization and specify its regulatory responsibilities and powers. Draft legislation supporting this initiative was released for comment by the Ministry of Finance in April 2001. At March 31, 2005, legislation has not yet been introduced.

# Notes to the Financial Statements

March 31, 2005

The Commission received approval from the Ministry of Finance to retain \$12.0 million, which may only be used toward implementation costs of the proposed merger and is subject to appropriate terms and conditions agreed with the Ministry of Finance, including:

- i) The monies will be paid to the Consolidated Revenue Fund, in part or in full, if not required to fund the costs of the merger; and
- ii) While retained by the Commission, the monies will be invested with the Ontario Financing Authority.

Investments are carried at cost, which approximates market value. The prime investment consideration for the reserve is the protection of principal and the appropriate liquidity to meet cash flow needs. Interest earned on investments is credited to the operations of the Commission.

## 6. CAPITAL ASSETS

	Cost	Accumulated Amortization	2005 Net Book Value	2004 Net Book Value
Office furniture	\$ 3,022,971	\$ 2,401,460	\$ 621,511	\$ 974,063
Office equipment	282,727	236,638	46,089	102,371
Computer hardware and related applications	11,960,201	9,627,749	2,332,452	2,273,178
Leasehold improvements	6,302,503	5,280,044	1,022,459	1,887,411
	\$ 21,568,402	\$ 17,545,891	\$ 4,022,511	\$ 5,237,023

## 7. PENSION PLANS

- a) The Commission's contribution to the Public Service Pension Plan for the year ended March 31, 2005 was \$2,294,755 (2004 – \$2,104,631) and is included in salaries and benefits.
- b) The unfunded supplemental pension plans for the Commission's Chair and current and former Vice-Chairs had an accrued benefit obligation of \$966,712 at March 31, 2005 (2004 – \$735,476) and an accrued benefit liability of \$1,114,747 (2004 – \$928,060). The Commission's related expense for the year was \$186,687 (2004 – \$114,929) and is included in salaries and benefits. No benefits were paid during the year (2004 – \$0). The average remaining service period of the active members covered by these plans ranges from 1.85 to 4.88 years at March 31, 2004 (2003 – .25 to 5.04 years); the 2004 figures were used for amortization purposes in fiscal 2005. The average life expectancy of the non-active member was 23.32 years at March 31, 2004 (2003 – not applicable). The significant actuarial assumptions adopted at March 31, 2005 include a discount rate of 5.5% (2004 – 5.5%) and a rate of compensation increase of 2.1%, if applicable (2004 – 2.5%).

## 8. STREAMLINING OF FEES UNDER THE SECURITIES ACT

Commencing on March 31, 2003, the Commission introduced a new fee model under the provisions of the *Securities Act*. The new fee regime is designed to accomplish three primary objectives; to reduce the overall fees charged to market participants from what existed previously in Ontario, to create a clear and streamlined fee structure, and adopt fees that accurately reflect the Commission's costs of operations.

The fee regime is based on the concept of "participation fees" and "activity fees". Participation fees represent the benefit derived by market participants from participating in Ontario's capital markets. Activity fees represent the direct cost of Commission staff resources expended in undertaking certain activities requested of staff by market participants.

Under this fee model, the Commission sets fees estimated to reflect the cost of regulation over a three-year horizon. While it was initially planned that any surplus or deficit incurred over a three-year period would be reflected when the fees were reset, fees received have exceeded expectations. The Commission has therefore issued a one-time rebate of fees of \$14,935,360 to expedite the return of surplus to the market participants who funded it. The General Operating Surplus at March 31, 2005 of \$32,805,359, adjusted for the surplus or deficit in fiscal 2006, will be reflected in the fees set for the following three-year cycle beginning in fiscal 2007.

Details of fees received for the year ended March 31, 2005 are as follows:

	2005	2004
Participation and Transitional Fees	\$ 64,008,748	\$ 60,706,698
Activity Fees	12,436,046	11,765,826
Late Filing Fees	2,000,030	2,382,418
<b>Total</b>	<b>\$ 78,444,824</b>	<b>\$ 74,854,942</b>

## 9. INVESTOR EDUCATION FUND

a) The Investor Education Fund (the "Fund") was incorporated by letters patent of Ontario dated August 3, 2000 as a non-profit corporation without share capital. The Fund is managed by an independent Board of Directors and its purpose is to increase knowledge and awareness among investors and potential investors and to support research and develop programs and partnerships which promote investor education. The Commission oversees the Fund as the sole voting member. The Fund is exempt from income taxes.

The Fund has not been consolidated in the Commission's financial statements. Financial statements of the Fund are available on request. Financial summaries of this unconsolidated entity as at March 31, 2005 and for the year ended March 31, 2005 are as follows:

### INVESTOR EDUCATION FUND

	2005	2004
<b>Financial Position</b>		
Total assets	\$ 5,790,235	\$ 7,037,458
Total liabilities	\$ 258,235	\$ 235,808
Invested in capital assets	843,804	753,806
Available for Fund purposes	4,688,196	6,047,844
Total net assets	5,532,000	6,801,650
	\$ 5,790,235	\$ 7,037,458

### Results of Operations

Total contributions and interest income	\$ 454,897	\$ 700,852
Total expenses	1,724,547	1,331,577
Deficiency of revenue over expenses	\$ (1,269,650)	\$ (630,725)

### Cash flows

#### Cash flows from operating activities

Cash receipts from the Ontario Securities Commission	\$ 333,559	\$ 474
Cash receipts from third parties	59,625	500,000
Investment income received	123,827	207,033
Cash paid for initiatives and expenses	(1,411,793)	(1,180,041)
Cash paid for capital purchases	(441,100)	(671,792)
Net decrease in cash position	(1,335,882)	(1,144,326)
Cash position, beginning of period	6,271,144	7,415,470
Cash position, end of period	\$ 4,935,262	\$ 6,271,144

b) In the normal course of operations, the Commission entered into transactions with the Fund as follows:

- The Board of the Commission authorized transfers totalling \$333,559 of the Commission's Designated Settlements to the Fund (2004 – \$0) in accordance with the Minister's approval and its own authority under the *Securities Act*.
- The Commission has a Management Services agreement with the Fund for the provision of administrative and management services, at cost.

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## ONTARIO SECURITIES COMMISSION 2005 Annual Report

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